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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Federal State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
Forward-Looking Mechanism For High Cost Support	)	CC Docket No. 97-160

**PROPOSAL BY U S WEST COMMUNICATIONS, INC.
FOR ADOPTION OF THE
INTERSTATE HIGH COST AFFORDABILITY PLAN**

U S WEST Communications, Inc. ("U S WEST") hereby submits the Interstate High Cost Affordability Plan ("IHCAP") as a modification to the Federal Communications Commission's ("Commission") 25/75 plan for the distribution of high-cost support for non-rural local exchange carriers ("LEC").[1]

I. THE COMMISSION'S "25/75 PLAN" PUTS SIGNIFICANT PRESSURE ON RATES FOR LOCAL SERVICE IN RURAL AND LESS DENSELY POPULATED STATES

In Section 254 of the Telecommunications Act of 1996 ("1996 Act"), Congress directed the Commission to ensure that universal service mechanisms are "specific, predictable, and sufficient"[2] and that rates be "just, reasonable, and affordable"[3] for

[1] In the Public Notice, DA 98-715, rel. Apr. 15, 1998 ("Notice"), the Commission requested interested parties to submit proposals for modifying the Commission's methodology for determining high cost support for non-rural LECs.

[2] 47 U.S.C. § 254(b)(5).

[3] 47 U.S.C. § 254(b)(1).

the "preservation and advancement of universal service."[4]

In the Universal Service Order, the Commission adopted a model for a High-Cost Fund for non-rural LECs which would provide federal funding for only 25% of the cost of universal service. The states would be responsible for providing funding for the remaining 75% of the costs of providing universal service.[5]

Attachment I, "Funding Universal Service: National Fund vs. Separate Funds" and the accompanying 50-state comparison, illustrates the states in which the Commission's 25/75 plan places significant upward pressure on the rates for local service as well as the magnitude of the pressure.

II. THE IHCAP OFFERS A REASONABLE ALTERNATIVE

Attachment II, "Interstate High Cost Affordability Plan," and Attachment III, "What If Federal Fund Covered All Costs Over $50," explain U S WEST's proposed modification to the Commission's 25/75 Plan. U S WEST refers to its proposal as the IHCAP. The IHCAP builds upon the basic architecture of the Commission's 25/75 Plan:

(1) Under $30: For loop costs under $30, the IHCAP would provide no federal support.

(2) $30 - $50: Under IHCAP, the federal fund would provide explicit support for 25% of the costs between a Primary Benchmark of $30 and a Super Benchmark of $50, and the states would provide support for the remaining 75% of the costs between these Benchmarks as they do under the Commission's 25/75 plan.

[4] 47 U.S.C. § 254(b).

[5] In the Matter of Federal-State Joint Board on Universal Service, Report and Order, 12 FCC Rcd. 8776, 8888 ¶ 201 (1997); appeal pending sub nom. Texas Office of Public Utility Counsel v. FCC, No. 97-60421 (5th Cir.).

(3) Over $50: For those supra-high-cost areas where the per-customer cost of supporting universal service under the Commission's 25/75 plan is so high that service could become unaffordable, the IHCAP will provide explicit federal support for all costs above the $50 Super Benchmark.

IHCAP allows the Commission to target those supra-high-cost areas where the Commission's 25/75 Plan alone was inadequate to cover the supra-high-cost of providing universal service in predominantly rural and low-density states in the South, the Midwest, New England, and the West.

III. CONCLUSION

At the conclusion of the comment cycle, U S WEST requests that the Commission modify the 25/75 Plan by implementing the IHCAP.

Respectfully submitted,

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April 27, 1998

Attachment I

FUNDING UNIVERSAL SERVICE
NATIONAL FUND vs. SEPARATE FUNDS
(April 1998 - Issue No. 2)

NOTE: In October of 1997, U S WEST presented the first issue of this paper. The numbers used in that issue consisted of a \$13.7B fund for both "rural" and "non-rural" LECs. This second issue reflects non-rural LECs only, and involves a \$4.5B fund which results from using the FCC "Common Inputs" in the BCPM model[1].

The Communications Act of 1996 requires that implicit support for universal service be removed from LEC rate structures and replaced with "specific, predictable and sufficient" explicit support mechanisms. The size of the high-cost fund which will be necessary to support affordable service in rural America has been the subject of considerable debate. The size of the necessary fund has been estimated to range from as low as \$6B to as high as \$20B for the entire telecommunications industry. The FCC currently has an inquiry underway to develop a cost proxy model which will be used to size the fund and target support to high cost areas. In the illustration which follows, a fund size of \$4.5B for the Non-Rural LECs only is used.

Once the size of the explicit support requirements for each state is determined, a mechanism must be developed to collect the necessary funds from all telecommunications providers on a competitively neutral basis. Two scenarios have been discussed for raising the necessary funds:

- A National fund, where the total funding requirements across all states are divided by the sum of all state and interstate revenues to compute a common surcharge for intrastate and interstate revenues.
- Separate State and Interstate funds, where 75% of the funding requirements are divided by each state's intrastate revenues to determine a state-specific intrastate surcharge, and the remaining 25% of the funding requirements are divided by total interstate revenues to develop an interstate surcharge.

The attached charts show the results of these two scenarios. This analysis shows that while a National fund would require a uniform 2.3% surcharge on all interstate and intrastate telecommunications services, separate State funds to recover 75% of each state's universal service costs would range from a 20% surcharge in Wyoming, to zero in the District of

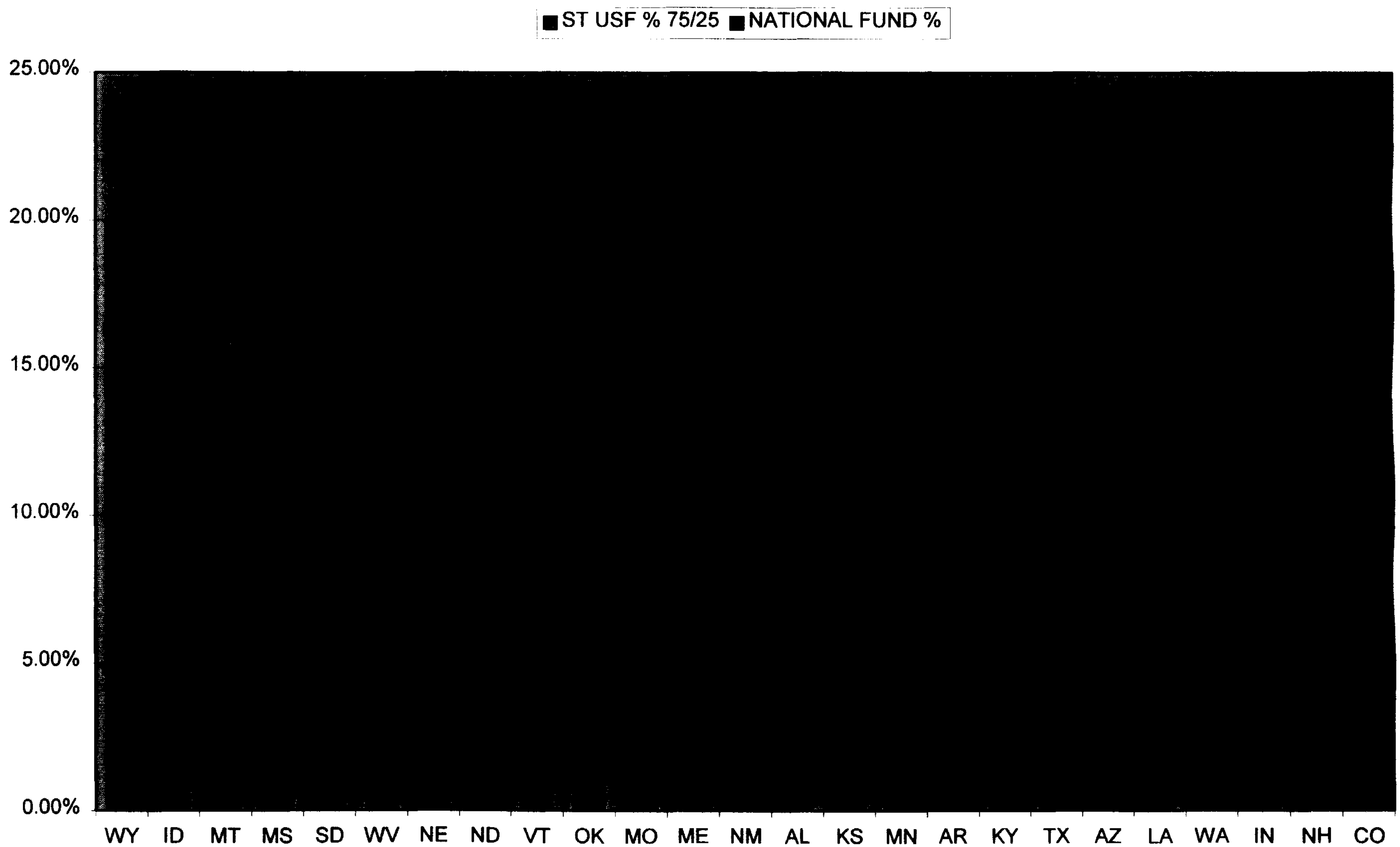
[1] Neither the BCPM nor the HAI sponsors endorse the use of the FCC "common inputs" for the determination of high-cost funding. They are used in this paper for illustrative purposes only.

Columbia.[2] For the most part, it is the western and southern states which would have the highest state-specific intrastate surcharges. Two factors interact to determine where a state falls on this continuum. The first is the number of high-cost customers within a state. The second and more important factor, however, is the number of low-cost customers within the state over whom the cost of supporting the high-cost customers can be spread.

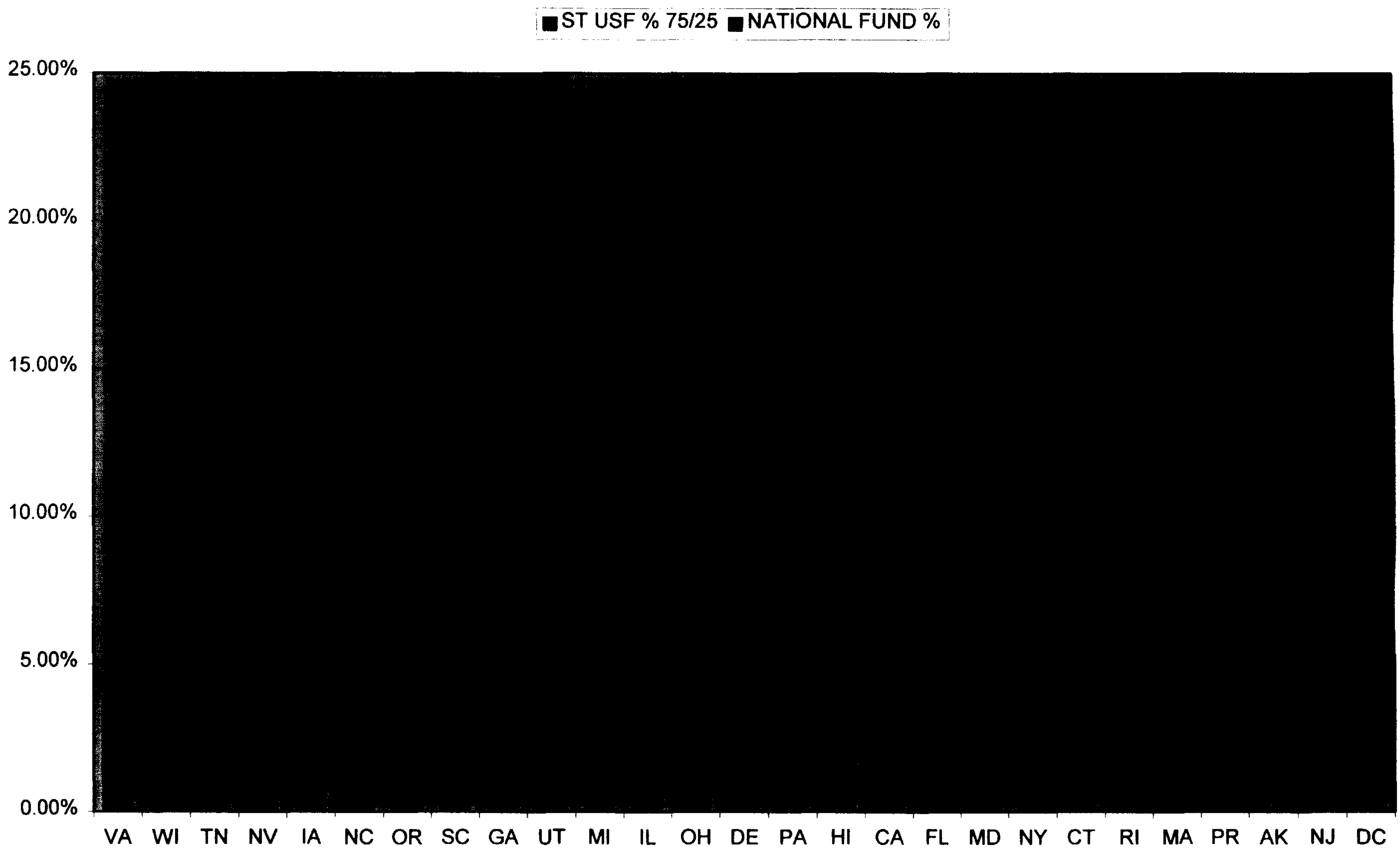
This data clearly shows why a National universal service fund will be required in order to fulfill the universal service goals of the 1996 Act. The disparity of funding assessment between states would require customers in the most costly states to pay total rates (basic rates plus surcharge) which may not meet the "affordability" standards of the Act. Furthermore, the wide disparity in assessment between the states could have unintended consequences on economic development. This is so since telecommunications is a vital element of commerce, and the disparate universal service surcharges on communications services between states could divert industries and job growth away from the rural areas which need it the most.

[2] In addition to the state-specific surcharge, a 1.5% surcharge on all interstate revenues would be required under the Commission's 25/75 scenario.

Non-Rural LECs "Common Inputs" (4.5B Fund)



Non-Rural LECs FCC "Common Inputs ($4.5B Fund)



Attachment II

"INTERSTATE HIGH COST AFFORDABILITY PLAN"
(April 1998)

The Interstate High Cost Affordability Plan ("IHCAP") is being proposed by U S WEST to assure the availability of affordable basic telephone service and network access to all Americans, particularly those living in rural and other high-cost areas. We believe that this plan can form a workable alternative to the plan previously proposed by the Commission which assigned 25% of the explicit high-cost funding responsibility to the federal jurisdiction, and the remaining 75% to the states. We appreciate the Commission's intention, expressed in its April 10, 1998 Report to Congress, to reconsider this issue.

The Telecommunications Act of 1996 ("1996 Act") states that customers in all regions of the Nation, including "rural, insular and high cost areas" should have access to telecommunications services and advanced services "at rates that are reasonably comparable to rates for similar services in urban areas." 47 U.S.C. § 254(b)(3). The 1996 Act also provides that implicit support currently contained in LECs' rate structures should be replaced with explicit support which is "specific, predictable and sufficient." 47 U.S.C. § 254(b)(5).

In its May 8, 1997 Universal Service Order, the Commission laid out a plan for accomplishing the directives of the 1996 Act. It defined a "benchmark" level (roughly $30 for residential customers) above which explicit universal service support would be required to assure affordable service. It also directed that a "proxy cost model" be developed to determine the cost of serving customers by "small areas of geography," such as Census Block Groups, Wire Centers or Grids. Costs for customers above the benchmark level would be aggregated and recovered from an explicit universal service mechanism. Recovery of these costs would be divided, with 25% of these costs recovered from an Interstate fund, and the remaining 75% of the costs recovered from separate State funds developed and administered by each state. The problem is that, for some states, removing all of the present implicit support and making it explicit would result in surcharges which could, themselves, threaten the basic concept of affordability. Under the Commission's 25/75 Plan, it is obvious that many rural states experience a significantly more disproportionate impact than the more urban states.

The IHCAP solves this problem by defining a second Super-Benchmark to identify the "very-high" cost customers. Costs between the Primary Benchmark ($30/month) and the Super-Benchmark ($50/month) would be handled the same as in the Commission's 25/75 Plan, with 25% of the funding responsibility assigned to the interstate jurisdiction, and the remaining 75% assigned to the states. Costs above the Super-Benchmark would be assigned 100% to the interstate jurisdiction. Attachment III, "*What if a Federal Fund Covered All Costs Over $50?*" was developed as a result of discussions during and around the NARUC Convention in Boston, and has been reviewed in concept with many Federal and State regulators and other interested parties. The numbers used in the paper, similar to those in Attachment I, reflect the "common inputs" developed by the Commission staff. Based upon our analysis to date, removing these "super-high" costs from the intrastate equation would appear to level the playing field, and leave each state with a more solvable problem.

One advantage of the IHCAP is that it leaves the primary role for rebalancing rates, defining the need for explicit support, and assuring the continued availability of affordable service with the people who know the local customers and the local markets best - the State regulators. The size of the interstate fund is kept smaller by assuming full support responsibility only for those costs in excess of $50/month (states would still be responsible for 75% of the costs between $30 and $50). The interstate fund would cover 25% of costs between $30 and $50, and 100% of customer costs in excess of $50. Most of the customers who would be eligible for funding under the single-benchmark proposal, and a significant portion of the funding need, is due to customers slightly above the $30 Primary Benchmark but less than the $50 Super-Benchmark. By leaving responsibility for most of these costs with the states, state regulators will be able to devise rate rebalancing and/or explicit funding plans which are right for their markets. This plan also reduces the burden on customers in lower cost states, since it only requires them to contribute support to those customers who unquestionably will require some sort of assistance to retain affordable service.

We believe that the IHCAP helps to bridge the differences between states as they attempt to remove implicit supports, rebalance rates, and establish sustainable explicit support mechanisms consistent with the new competitive environment. Some states can handle universal service themselves. All states have some customers who are located far from the central office and are costly to serve. What makes the impact of removing all present implicit funding more severe in some states than others is the relative number of low-cost customers within the state. While states like California and New York have many high-cost customers to support, they also have large concentrations of low-cost customers in major urban areas to spread this support over. As a result, the per-customer impact of supporting high-cost customers is relatively small. Other states, such as Montana, Wyoming and the Dakotas, have many very high-cost customers, but lack the large urban centers to spread these costs over. As a result, the per-customer cost of supporting universal service could become so high that affordable service for all customers in the state would become an issue. The purpose of the IHCAP is to remove the very high end of the cost average, so that all states are capable of solving the remaining universal service problem themselves.

The need for a plan like IHCAP is not limited to the western states served by U S WEST. Southern states, such as Mississippi, Kentucky and Alabama, New England states such as Vermont, New Hampshire and Maine, and Appalachian states like West Virginia have similar problems with many high-cost customers and relatively few low-cost customers. The IHCAP has been designed to benefit all Americans.

Lower cost states also benefit from IHCAP for two reasons. First, all states have some customers who are costly to serve. The IHCAP fund will support very high-cost customers in all states, reducing the size of the problem that each state must deal with. Second, customers in all areas of the country benefit from ubiquitous access to all people and businesses nationwide. High cost and rural areas possess agricultural, energy and recreational resources on which urban areas depend. Rural areas contain many customers for goods and services produced in urban areas. IHCAP assures affordable service for all Americans, consistent with the directives of the 1996 Act.

The Commission's May 8, 1997 Report and Order provides for the implementation of a new explicit funding framework for "non-rural" LECs on January 1, 1999, but retains the current funding mechanisms for "rural" LECs until at least 2001. U S WEST believes that the IHCAP can be implemented by January 1, 1999. One reason for this is that the Plan functions similarly to the present USF, where study area average costs in excess or 115% of the national average are removed from the interstate jurisdiction and recovered through explicit funding in the interstate jurisdiction. IHCAP modernizes this process by using a proxy model to develop costs for small areas of geography, such as a Census Block Group, and targeting high-cost support to those customers who need it most. Competition eliminates the ability of "non-rural" LECs to use geographic averaging as a means to subsidize high-cost customers with low-cost customers. Thus, IHCAP is consistent with the competitive marketplace which the 1996 Act creates.

IHCAP is intended for non-rural LECs only, at this time. After several years of experience under IHCAP, the Commission will be in a better position to decide what explicit funding plan will best meet the needs of rural LECs and their customers. One thing that we are sure of going forward, however, is that the focus of the Commission's universal service funding programs and principles should be on the needs of the rural customer, and not on the size of the company which serves them. In years gone by, it may have made sense to set up explicit funding for smaller LECs (which generally serve high-cost territory) and allow the larger LECs to cross-subsidize their higher cost rural customers with lower cost urban customers. The ability of new local competitors to selectively enter local markets effectively eliminates this opportunity for cross-subsidy.

Until the Commission completes the cost proxy model proceeding and selects the model platform and inputs, the absolute size of the fund can only be estimated. Estimates for the total high-cost funding needs of the non-rural LECs range from a low of $3 billion to a high of about $9 billion. This number is highly sensitive to the cost inputs to the proxy model. During the platform proceeding, the Commission staff has developed a set of "common inputs" which, when run through both the BCPM3 and HAI 5.0a models produce a similar total funding need of around $4.5 billion for non-rural LECs. These are the numbers reflected in the white papers attached. Using $4.5 billion, and recognizing that the final number could be slightly higher or slightly lower, the baseline 25%

interstate funding portion would be approximately $1.1 billion, requiring a surcharge of approximately 1.5% on interstate retail revenues. When the fund is increased to cover 100% of the costs above $50, the interstate fund for non-rural LECs would become $2.8 billion, or a 3.9% surcharge. Again, we must stress that these estimates are preliminary, and subject to change based upon the outcome of the proxy model proceeding.

The creation of this fund, however, would not mean that customers' bills would increase by 3.9%. An explicit high-cost fund is intended to be a replacement for implicit support hidden within present LEC rate structures. Offsetting reductions would be made elsewhere in the rate structure, so that the net impact to consumers would be zero. The impact to the high-cost rural customers, however, would be significant, because they would be assured of the continued availability and affordability of basic telephone service and network access.

Attachment III

WHAT IF THE FEDERAL FUND COVERED ALL COSTS OVER $50?

(April 1998 - Issue No. 2)

NOTE: In November of 1997 U S WEST presented the first issue of this paper. The numbers used in that issue consisted of a $13.7B fund for both "Rural" and "Non-Rural" LECs. This second issue reflects Non-Rural LECs only, and involves a $4.5B fund which results from using the FCC "Common Inputs" in the BCPM model[1].

Previous Analysis of the surcharges which would be necessary to fund universal service if states are required to fund 75% of the high-cost need, has indicated that some states would experience a significant burden which, itself, could threaten affordable service. This analysis attempts to modify the funding scenario by making the following modifications:

- Each state would fund 75% of the requirement between a $30 benchmark and a $50 benchmark.
- Funding amounts beyond a $50 benchmark would be assigned 100% to the interstate fund.

In the attached charts the following legend is used.

Series 1	States fund 75% of all costs over the $30 benchmark
Series 2	Federal surcharge required to fund the remaining 25%
(NOTE:	Series 1 & 2 are the same as on our earlier Charts)
Series 3	States fund 75% of the need between the $30 and $50 benchmarks
Series 4	Federal surcharge funds 25% of the need between $30 and $50
plus	100% of the need over $50.

In reviewing the data on the charts, the following observations can be made:

- For all states, the surcharge under the second scenario is less than or equal to the funding assuming full 75% recovery.
- By removing the high end of the cost average, the burden on the highest surcharge states is substantially reduced, and is in the range of the required federal surcharge.

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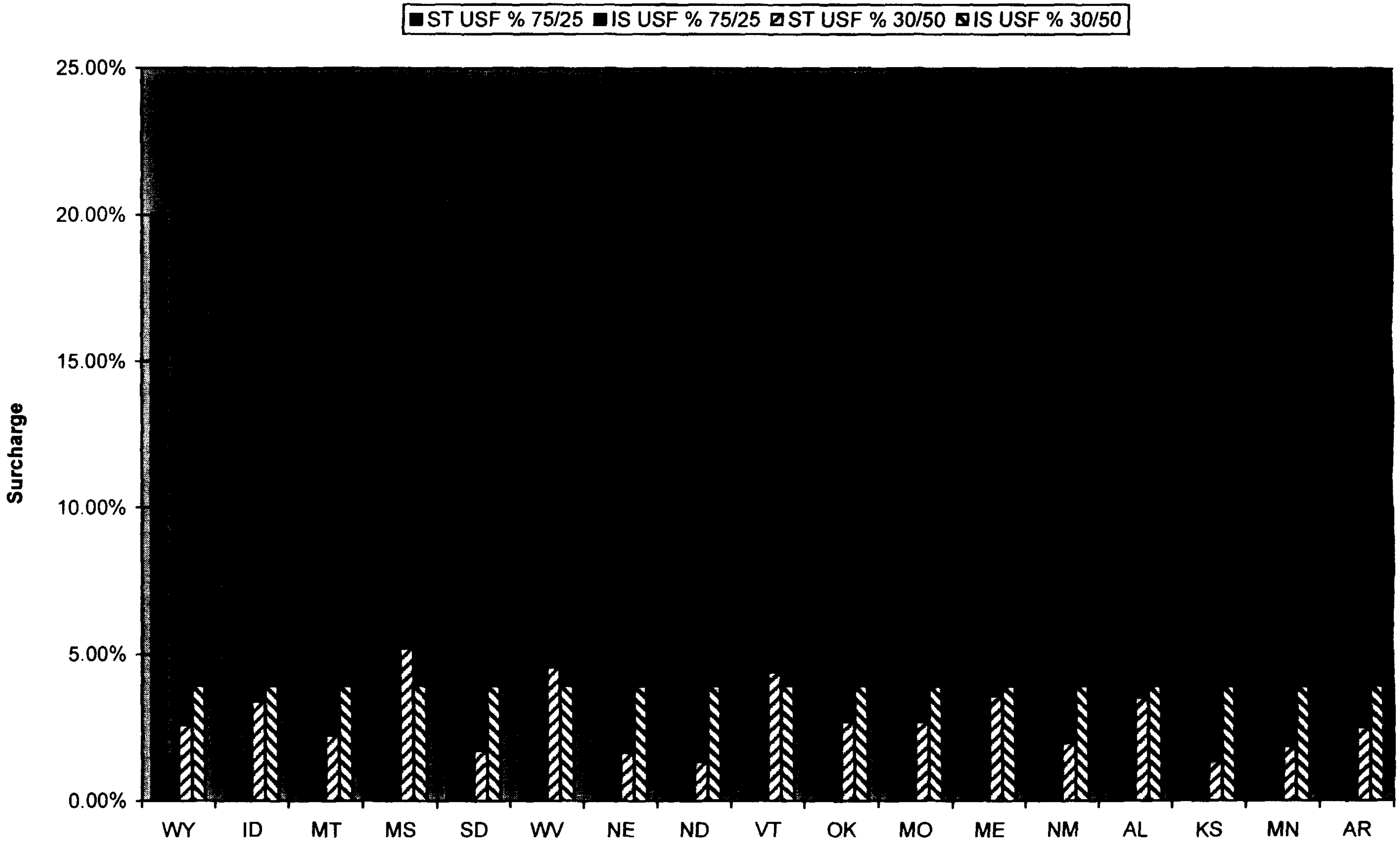
[1] Neither the BCPM nor the HAI sponsors endorse the use of the FCC "common inputs" for the determination of high-cost funding. They are used in this paper for illustrative purposes only.

- While the federal surcharge more than doubles, it is still within a "reasonable" range and it will assure that all Americans, particularly those in the most costly regions, will have access to affordable basic service.

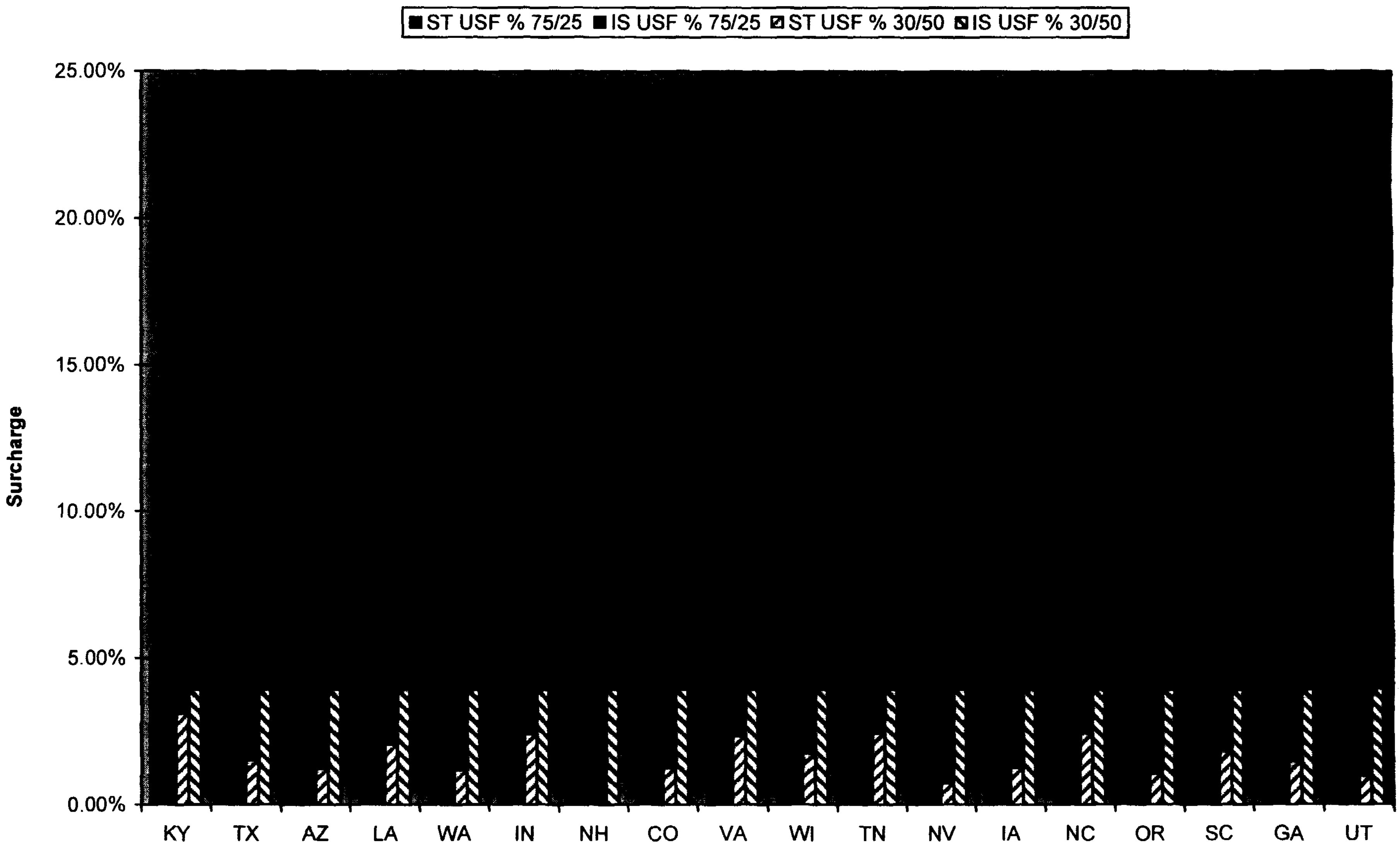
This analysis was performed at an assumed funding need of approximately $4.5B which is the result of running the BCPM3 model at the FCC "Common Input" values. No matter what the final funding requirements, however, the relative proportions shown on the attached charts are likely to remain constant.

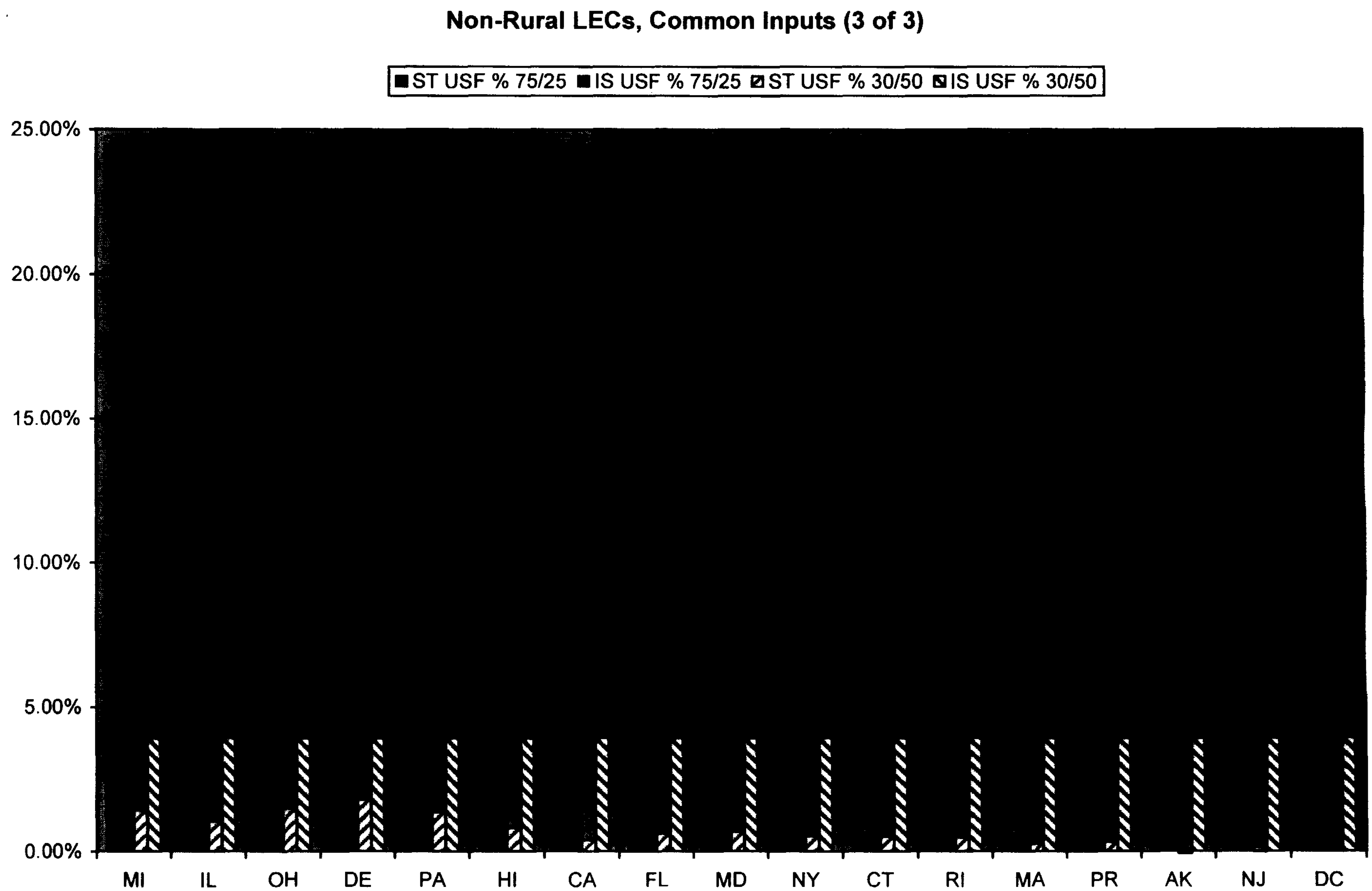
U S WEST
April, 1998

Non-Rural LECs, Common Inputs (1 0f 3)



Non- Rural LECs, Common Inputs (2 of 3)





Non-Rural LECs, Common Inputs (3 of 3)
ST USF % 75/25
IS USF % 75/25
ST USF % 30/50
IS USF % 30/50
25.00%
20.00%
15.00%
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CERTIFICATE OF SERVICE

I, Kelseau Powe, Jr., do hereby certify that on this 27th day of April, 1998, I have caused a copy of the foregoing **PROPOSAL BY U S WEST COMMUNICATIONS, INC. FOR ADOPTION OF THE INTERSTATE HIGH COST AFFORDABILITY PLAN ("IHCAP")** to be served, via first class United States Mail, postage pre-paid, upon the persons listed on the attached service list.

Kelseau Powe, Jr.

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